BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The decision of the Circuit Court of Appeals in affirming the injunction is in conflict with the following decisions of this court: *Mandeville* v. *Canterbury*, 63 S. Ct. 472; *Toucey* v. *New York Life Ins. Co.*, 314 U. S. 118; *Southern Ry.* v. *Painter*, 314 U. S. 155; *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168; *Railroad Comm'n* v. *Pullman Company*, 312 U. S. 496; *Md. Casualty Co.* v. *Pacific Co.*, 312 U. S. 270; *Texas* v. *Donoghue*, 302 U. S. 284; *Kline* v. *Burke Construction Co.*, 260 U. S. 226; *Foust* v. *Munson S. S. Lines*, 299 U. S. 77; *Commonwealth Company* v. *Bradford*, 297 U. S. 613; *Riehle* v. *Margulies*, 279 U. S. 218.

Whether the proceeding to judicially settle the account of Manhattan Company is a proceeding in the bankruptcy reorganization, which was consummated in 1938, or is an independent proceeding over which the District Court, but not as a bankruptcy court, (if it had jurisdiction) had at most concurrent jurisdiction with the state court, is unimportant.[1]

---

[1] The Circuit Court of Appeals in *Central Hanover Bank & Trust Company* v. *Manhattan Company*, supra, apparently recognized that the accountings were not proceedings in the bankruptcy reorganization since it ruled that the District Court in its discretion need not take jurisdiction but might permit the accounting suits to be in another forum, the state court, which would not be the case if such accountings were proceedings in bankruptcy over which the bankruptcy court had exclusive non-delegable jurisdiction. The Court further recognized this in *Manufacturers Trust* v. *Kelby*, supra, when it stated that allowing the reorganization trustees to intervene in the accounting proceedings was a matter "for the discretion of the District Judge within the discretion vested in him by Rule 24(b)." If the accounting suits were part of the bankruptcy reorganization, the debtor's trustees would be the only necessary parties thereto and their substantive rights and duties to appear and participate therein would emanate from the Bankruptcy Act itself and would not be procedural ones predicated on dis-

(Footnote continued on next page)

In neither case is there any jurisdiction to enjoin the state court action in the absence of any *res* and interference with control of it.

A federal court does not have power to enjoin parties from prosecuting a suit in a state court merely because the claim in controversy has previously been adjudicated in a suit in the federal court to which they were parties, *much less where, as here, they were not parties to such suit.* Where the action first brought is *in personam* another action for the same cause in another jurisdiction is not precluded. Even when the first action is *in rem* or *quasi in rem* and the court still has possession and control of the *res* (as it does not here) it should not restrain another court from entertaining an action *in personam.*

Whether petitioner's suit in the state court and whether the accounting proceeding of Manhattan Company (the former trustee) in the federal court are *in personam* or *in rem* or *quasi in rem* depends on and can be resolved only by solution of the primary questions, that is: What are the rights against Manhattan Company of former and present bondholders of the debtor who were such when unauthorized surrenders of collateral occurred? What are the rights against Manhattan Company of present bondholders of the debtor who were not such when unauthorized surrenders of collateral occurred? Each of these questions is one of state property law.[2]

---

cretion lodged in the District Judge by a rule of procedure extraneous to said Act. It seems clear when the debtor's trustees complied with the directions in the order directing them to assign, transfer and set over the trust funds to the new corporation, the bankruptcy court lost further jurisdiction over the trust funds. Section 70(i) of the Bankruptcy Act. *Bell* v. *Roberts,* 112 F. 2d 585, *Nassau Works* v. *Brightwood Co.,* 265 U. S. 271.

[2] The Circuit Court of Appeals intimated that there may be doubt as to whether *Erie* v. *Tompkins,* 304 U. S. 64, applies here (R. 963). It, however, decided in *Manufacturers Trust Company* v. *Kelby* that state law applies. Questions of this sort arising in cases in the Federal Courts were solved by reference to state law even before *Erie* v. *Tompkins. In re Prudence Company,* 2 Cir.,

In limine, it should be noted that petitioner's suit against Manhattan Company in the state court and the claims urged against it in its accounting proceeding in the District Court are not for the recapture of any property (trust *res*) which was pledged by the debtor with it as security for the payment of the debtor's bonds since Manhattan Company did not acquire any of such property to its own use, but are for damages[3] because it, without authority, released the lien it held for bondholders on some of such property by surrendering it to the owner, the debtor.

This court has spoken recently and forcefully upon the subject of interference by federal courts with suits in state courts. In *Toucey* v. *N. Y. Life Ins. Co.*, 314 U. S. 118, 132, Mr. Justice FRANKFURTER sums up an historical discussion in these words:

> 'Regardless of the various influences which shaped the enactment of §5 of the Act of March 2, 1793, the purpose and direction underlying the provision are

---

82 F. 2d 775, where the court held that the trust agreements under which these Prudence Bonds were issued were New York contracts governed by New York law. *Vide Spindle* v. *Shreve*, 111 U. S. 542; *Pugh* v. *Frierson*, 6 Cir., 221 F. 513; *Mutual Life Insurance Co. of New York* v. *Johnson*, 293 U. S. 335; *Jones* v. *Third National Bank*, 8 Cir., 13 F. 2d 86; *Smith* v. *Bucyrus Co.*, 5 Cir., 31 F. 2d 514; *Allen* v. *Tate*, 8 Cir., 6 F. 2d 139, p. 140. State law would govern here even if *Swift* v. *Tyson*, 16 Pet. 1, in the language of Judge Frank (R. 965) "were still alive and kicking." Cf. *Philco Corp.* v. *Phillips Mfg. Co.*, 7 Cir., 133 F. 2d 663.

[3] That a bondholder who was such when an indenture trustee commits a breach of trust by releasing or surrendering to a debtor-mortgagor property pledged to secure the payment of the bonds has a right to sue the indenture trustee for his damages (*in personam*) because of such breach is well settled. *Hunsberger* v. *Guaranty Trust Co.*, 164 App. Div. 740, aff'd 218 N. Y. 742; *Margulies* v. *Manufacturers Trust Company*, 148 Misc. 564; *Savings Bank of New London* v. *New York Trust Company*, 27 N. Y. S. (2d) 963 (p. 973); *Benton* v. *Safe Deposit Bank*, 255 N. Y. 260; *Ansbacher* v. *New York Trust Company*, 280 N. Y. 79; *Bank of New York* v. *New Jersey Title Guarantee & Trust Co.*, 256 App. Div. 609; *James* v. *Cowing*, 82 N. Y. 449; *Rheem* v. *Allnut*, 64 F. 2d 549; *Young* v. *Howard*, 120 F. 2d 712; *Browning* v. *Fidelity Trust Company*, 250 Fed. 321, cer. den. 248 U. S. 564.

> manifest from its terms: proceedings in the state courts should be free from interference by federal injunction. The provision expresses on its face the duty of "hands off" by the federal courts in the use of the injunction to stay litigation in a state court.'

In a footnote the learned Justice says further that section 262 of the Judicial Code is derived from section 14 of the Judiciary Act of 1789 and that the general powers given in it to federal courts were obviously limited by the subsequent enactment of the specific prohibitory provisions of the Act of 1793.

The opinion in that case closes with these words of constraint:

> 'We must be scrupulous in our regard for the limits within which Congress has confined the authority of the courts of its own creation' (p. 141).

The *Toucey* case involved what are known as 'relitigation cases' and it was for the preservation of that basis of federal injunction that the dissenting justices stood as shown by their subsequent concurrence in *Southern Ry* v. *Painter,* 314 U. S. 155, 160, where there was no federal decree outstanding and therefore no question of relitigation.

These two cases, in the first of which federal judgments had determined the very issues sought to be litigated in the state courts between the same parties and in the second of which an earlier suit was pending in the federal court, plainly show the position of this court upon the subject.

Chicago v. *Fieldcrest Dairies,* 316 U. S. 168, is decisive. That was a suit in the district court to restrain the city and its officials from prohibiting the use by respondent of paper containers for the distribution of milk. It involved (1) the construction of an ordinance, (2) if applicable, whether the ordinance was in conflict with a state statute, (3) if applicable and valid under the state statute, whether the ordinance violated the Federal Constitution. A later suit had been brought in the state court by another cor-

poration, in which substantially the same issues were raised. It was held that the case should be held by the federal court to await the outcome of the later suit in the state court. Mr. Justice DOUGLAS disposed of arguments also presented here, as follows:

> 'As we said in the *Pullman* case, "The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision" and any "needless friction with state policies." See p. 500 and cases cited; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483-484. It is an exercise of a "sound discretion, which guides the determination of courts of equity." *Beal* v. *Missouri Pacific R. Co., supra,* p. 50. In this case, that discretion calls for a remission of the parties to the state courts, which alone can give a definitive answer to the major questions posed. Plainly, they constitute the more appropriate forum for the trial of those issues. See 54 Harv. L. Rev. 1379. Considerations of delay, inconvenience, and cost to the parties, which have been urged upon us, do not call for a different result. For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole.
>
> The desirability of the course which we have suggested is not embarrassed by any question as to whether ready recourse may be had to the state courts. The availability of the state tribunal is obvious, since a case involving substantially identical issues and brought by respondent's parent corporation is pending in the state court. Cf. *Gilchrist* v. *Interborough Rapid Transit Co.*, 279 U. S. 159' (p. 172).

There is nothing novel in either the doctrine or the procedure approved in *Chicago* v. *Fieldcrest Dairies, supra.* In *Railroad Comm'n* v. *Pullman Co.*, 312 U. S. 496, 500, Mr. Justice FRANKFURTER said:

> 'In this situation a federal court of equity is asked to decide an issue by making a tentative answer which

> may be displaced tomorrow by a state adjudication. *Glenn* v. *Field Packing Co.*, 290 U. S. 177; *Lee* v. *Bickell*, 292 U. S. 415. The reign of law is hardly promoted if an unnecessary ruling of a federal court is thus supplanted by a controlling decision of a state court. The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision as well as the fruition of a premature constitutional decision.'

In re 4145 Broadway Hotel Co., 124 F. 2d 891, the bankruptcy court restrained the prosecution in the state court of a libel suit against the trustees in reorganization, under section 77B, *and another defendant.* The Circuit Court of Appeals, Seventh Circuit, reversing called attention to the fact that plaintiff in the state court action did not seek to interfere with property in the custody of the bankruptcy court and that the restraining order was not necessary to effectuate any decree entered in the reorganization proceeding but that the action in the state court was an action in tort, brought against the trustees personally, *and plaintiff sought a judgment against the defendants personally for their wrongful acts.* This decision was based upon *Toucey* v. *New York Life Ins. Co., supra.*

> See also *Denver-Greeley Valley Water Users Ass'n* v. *McNeil*, 10 Cir., 131 F. 2d 67; *Armstrong* v. *Alliance Trust Co.*, 5 Cir., 126 F. 2d 164; *Empire Trust Co.* v. *Brooks*, 5 Cir., 232 F. 641; *McClellan* v. *Carland*, 8 Cir., 187 F. 915; *Boynton* v. *Moffat*, 10 Cir., 57 F. 2d 772, with all of which decisions the decision under review is in conflict.

In *Firemen's Fund Ins. Co.* v. *Crandall Horse Co.*, 47 F. Supp. 82, the Court analyzes the cases upon which petitioner relies and draws from them the same conclusion.

The powers of a bankruptcy court are defined by this Court in *Toucey* v. *N. Y. Life Ins. Co., supra.*

At page 132, immediately after his summation of the rule of 'hands off' which we have quoted, Mr. Justice FRANKFURTER takes up the exceptions to it and says:

> '*Second.* The language of the Act of 1793 was unqualified: " * * * nor shall a writ of injunction be granted to stay proceedings in any court of a state * * * " 1 Stat. 335. In the course of one hundred and fifty years, Congress has made few withdrawals from this sweeping prohibition:
>
> (1) *Bankruptcy proceedings.* This is the only legislative exception which has been incorporated directly into §265: " * * * except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy." 36 Stat. 1162. This provision, based upon §21 of the Bankruptcy Act of 1867, 14 Stat. 526, was inserted in the Act of 1793 by the Revisers, R.S. §720; see Proposed Draft of Revision of U. S. Statutes (1872), vol. 1, p. 418.'

Section 21 of the Bankruptcy Act of 1867 related exclusively to suits against the bankrupt based on debts or claims provable and dischargeable under the Act in the bankruptcy.

This section has been carried over into the present Bankruptcy Act as Section 11(a), U. S. C. A. §29. It provides a suit which is founded upon a claim from which a discharge would be a release and which is pending against a person at the time of the filing of a petition against him shall be stayed until after an adjudication or the dismissal of the petition. Clearly it does not cover the present application of these petitioners.

Section 116 of the Bankruptcy Act, U. S. C. A. §516, provides in subdivision 4 that the judge may:

> 'in addition to the relief provided by section 11[4] of this title, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.'

---

[4] U. S. C. A. § 29.

Clearly this section does not cover the present application since no suit has been commenced against the debtor or its trustee and there has been no act or proceeding to enforce a lien upon the property of the debtor.

Authority for an injunction in the case now here must be found if at all in section 2(15) of the Bankruptcy Act, U. S. C. A. §11, as an exception to the general rule laid down in section 265 of the Judicial Code.

Section 2(15) empowers the court to 'make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title'.

The power vested by section 2(15) and 'within which Congress has confined the authority of the courts of its own creation' is dependent upon possession and need for protection of a *res*. This, under the rule in the *Toucey* case, *supra*, at page 139, is the only 'exception' which has been imbedded in section 265 by judicial construction.

Even in bankruptcy a federal court is prohibited by section 265 of the Judicial Code from staying an action in a state court unless it falls within sections 11a or 116 of the Bankruptcy Act, *supra*, or comes within the *res* cases.

We are therefore brought to a consideration whether the present application is within those cases. As stated by Mr. Justice FRANKFURTER in the *Toucey* case, 'the fact that one exception has found its way into §265 is no justification for making another'.

Describing the *res* cases this Court said in *Kline* v. *Burke Construction Co.*, 260 U. S. 226, 235:

> 'The rule, therefore, that the court first acquiring jurisdiction shall proceed without interference from a court of the other jurisdiction is a rule of right and of law based upon necessity, and where the necessity, actual or potential, does not exist, the rule does not apply. Since that necessity does exist in actions in *rem* and does not exist in actions in *personam*, involving a question of personal liability only, the rule applies in the former but does not apply in the latter' (p. 235).

This interprets the condition precedent found in section 2(15) of the Bankruptcy Act where it is provided that such orders, process and judgments may be made 'as may be necessary for the enforcement of the provisions of this title.' The touchstone is necessity.

In re 4145 Broadway Hotel Co., supra.

Petitioner, as trustee of a testamentary trust, barred by the decision in *Manufacturers Trust Co.* v. *Kelby* from any way of enforcing the rights which it asserts in the bankruptcy, has brought an action for a money judgment, which is an action *in personam,* against Manhattan Company in its individual capacity.

Under the decisions of this Court, even if Brooklyn Trust Company individually was a bondholder when the acts complained of occurred and sold its bond prior to the debtor's reorganization, and as such was the plaintiff in the state court, the court would have had no power or jurisdiction to enjoin its suit.

In New York an action that is *in rem* or *quasi in rem* is defined by statute. Under subdivision 6 of Section 232 of the Civil Practice Act (Laws 1920, Chapter 925 as amended), an action *in rem* or *quasi in rem* is one "where the complaint demands judgment that the defendant be excluded from a vested or contingent interest in or lien upon *specific real or personal property* within the state; or that such an interest or lien in favor of either party be enforced, regulated, defined or limited; or otherwise affecting the title to *such property*" (emphasis supplied).

An action *in rem* or *quasi in rem* in New York is one which has for its object *specific property* in this State. The result of such an action is a judgment which operates upon the *specific property* and which has no element of personal claim or personal liability. On the contrary a common law

action for a money judgment has no specific subject matter and is, therefore, one *in personam.*

> *Hanna* v. *Stedman,* 230 N. Y. 326; *Carmody, New York Practice,* Vol. II, Sections 725, 726, 727; *Restatement of the Law of Judgments,* Chapter 1; Chapter 2, Section 32; Chapter 3, Sections 73 and 75; *Vide, Pennoyer* v. *Neff,* 95 U. S. 715; *Gorham Co.* v. *United E. & C. Co.,* 202 N. Y. 342, 348-349.

Petitioner is seeking a money judgment the effect of which will be to impose a personal liability upon Manhattan Company to pay it and upon which execution can be levied only against the *individual* assets of Manhattan Company and will not be enforced by execution out of any trust property or any other specific property, and thus *pro tanto* deplete the same. A judgment in petitioner's favor will not deal with any *res* and order its distribution.

The fact that it may be necessary for the state court to determine whether petitioner has a cause of action against Manhattan Company before it can award damages to it does not change its action *in personam* into one *in rem.* Even if petitioner's suit in the state court did not seek damages but were solely one for a declaratory judgment, i. e., whether it had a cause of action against Manhattan Company, it would be one *in personam.* (Cf. *Commonwealth Co.* v. *Bradford,* 297 U. S. 613). The state court does not seek to take any *res* into its custody. There is here no *res* susceptible of custody by any court.

Nor may any sum recovered by petitioner from Manhattan Company individually be brought into the reorganization for two reasons: First, because it is a *sine qua non* of recovery that its cause of action did not pass by assignment to present bondholders, and second, because the debtor has no property interest in such recovery.

Since the judgment sought in the accounting proceeding in the District Court is for the recovery of money damages from Manhattan Company it is *in personam.* Petitioner's suit in the state court is likewise *in personam* and neither

suit is *in rem* or *quasi in rem* because in neither case is the Court or its officer in any way in possession or control of any *specific property* which is the subject matter of the suit, which is a *sine qua non* to a *rem* or *quasi in rem* suit. There is here no *res* to which the jurisdiction of the District Court did or can attach and, therefore, no basis for the injunction.

The Circuit Court held in *Manufacturers Trust Company* v. *Kelby* and in the present case that the agreements securing the bonds made between the debtor and the corporate trustees created express trusts of which the bondholders were *cestui que trust.*

Assuming, as we must, therefore, that the rights of the bondholders are akin to those of such *cestuis que trust,* the rights of petitioner and all the other bondholders of the debtor against the former trustees who were such when such unauthorized acts on their part occurred are, in New York, individual ones *in personam* calling for the payment of damages and are not rights *in rem* or *quasi in rem* and they consequently cannot be made the basis of derivative suits on behalf of present bondholders' collateral against the trustees.[5]

Since Manhattan Company not only has no *res* or substitute in its hands, and never appropriated any *res* to

---

[5] This was conceded by the bondholder Eddy who was an appellee on the appeal in the Circuit Court of Appeals. He stated (p. 14 of his brief): "The objections interposed do not seek to trace any part of the trust *res* into the hands of third parties and the recovery for the specific *res* parted with, but to surcharge the trustee for the misapplication and depletion of the trust fund. A decree sustaining the objections and surcharging the trustee could only be a decree *in personam.* 17 Columbia Law Review, 467; 17 Columbia Law Review, 269; *Fur & Wool Trading Co., Ltd.* v. *Fox, Inc.,* 245 N. Y. 215 at 219."

That a derivative suit *in rem* to impress a constructive trust of any property released to the debtor by a former trustee and for its recapture could have been brought by a bondholder against the debtor while it had such withdrawn property if the trustee failed to bring an action for its restoration after demand, is beside the point. Cf. *O'Bierne* v. *Allegheny & K. R. R. Company,* 151 N. Y. 372.

its own use, the right and remedy of petitioner against it at all times was and still is one *in personam* for damages. Neither petitioner nor its decedent or any other bondholder similarly situated or any present bondholder, or anyone on his behalf, had or has the right to maintain a derivative suit *in rem* or *quasi in rem* against Manhattan Company which such suit would lie only for the recapture from it of the *res* or its substitute, none of which it has.[6]

Every argument in the opinion of the Circuit Court of Appeals for sustaining the injunction is either *ad hominem* or is in conflict with New York law and the decisions of this Court. The gist of the Court's argument is found (R. 965) where it refers to the power of a court in a first suit to restrain the proceeding in a second suit. The statements, like others in the opinion, arbitrarily assume the applicable substantive law to be the opposite to what it actually is. The injunction can be justified only by completely ignoring New York law and the decisions of this Court, and by depriving petitioner of its property without due process.

The attempt of the Court to create a *res* with the administration of which the state action may be said to interfere for the purpose of sustaining the injunction, upon the assumption that Manhattan Company is to be deemed to be or treated as if it had in its possession some of the

---

[6] *Fur and Wool Trading Co., Ltd.* v. *Fox, Inc.*, 245 N. Y. 215, 219; *Madison Trust Co.* v. *Carnegie Trust Co.*, 167 App. Div. 4, aff'd 215 N. Y. 475; *In re Sommers Estate*, 12 N. Y. S. 2d 47; *In re Petrosemolo*, 152 Misc. 419, 421; *Matter of Sullivan*, 177 Misc. 570, at pages 572-574, aff'd 289 N. Y. 323; *Matter of Ellensohn*, 258 App. Div. 891; *Matter of Dempsey*, 259 App. Div. 1083; *Mulligan* v. *Amo*, 211 App. Div. 498; *Agne* v. *Schwab*, 123 App. Div. 746; *Noll* v. *Smith*, 250 App. Div. 453; *Ostrander* v. *Ostrander*, 194 App. Div. 1, aff'd 233 N. Y. 582; *Mullin* v. *Mullin*, 119 App. Div. 521; *Oliver* v. *Piatt*, 3 How. 333; 43 U. S. 333; 11 L. Ed. 622; *United States* v. *Dunn*, 268 U. S. 121; *Schuyler* v. *Littlefield*, 232 U. S. 707; *May* v. *Leclaire*, 11 Wall. 217; *Smith* v. *Vodges*, 92 U. S. 183; "The Nature of the Rights of the Cestui que trust," 17 Col. L. R. 476 (Dean Stone); Scott on Trusts, Sections 202, 524(4); Restatement of the Law of Restitution, Sections 190 to 196, 215; Restatement of the Law of Trusts, Section 202.

debtor's property, is not only in conflict with all of the above cited authorities but is the merest fiction, the finding not of a *res* but of a *nominis umbra.* It is "a subtlety which does not merit judicial adoption." Such assumption is tantamount to a preposterous assertion that title to *all of the assets of Manhattan Company* is and has since the acts occurred been held by it as a constructive trustee out of which to satisfy any judgment against it either in petitioner's state court action or in the accounting proceeding. There should have been no temptation to indulge in legal fiction such as there might conceivably be if a judgment in the state court action would imperil the financial ability of Manhattan Company to comply with any judgment in the accounting proceeding.[7]

The Court to sustain its fictional *res,* in view of the fact that Manhattan Company has no collateral of the debtor and since petitioner does not seek to recover either ownership of or possession of any collateral, has resorted to a suppositional state of facts wherein a corporate trustee recognizing a liability for its acts puts its own promissory

---

[7] The bankruptcy court cannot constitutionally deprive petitioner and former bondholders similarly situated of their property rights to damages upon some equitable theory of constructive trust the effect of which is to take away their respective causes of action and transfer them to the debtor's collateral and thereby make it a part of the *res* over which that court had jurisdiction. Nor is there any equitable doctrine under which a constructive trust can be imposed on a recovery by petitioner and bondholders similarly situated in favor of assignees are intimated by the Circuit Court of Appeals (R. 973). Petitioner, like thousands of other Prudence bondholders, sold its bond at a loss and it may therefore recover from Manhattan Company damages which, when added to that realized on the sale, will probably be less than that originally paid for the bond but certainly not in excess thereof. The element of unjust enrichment necessary for the imposition of a constructive trust is wholy lacking. Contra it is more than likely that the present holder of this bond or his ultimate assignee will receive on the Circuit Court of Appeals' theory more than he paid for the bond and thereby be unjustly enriched, and this applies equally as well to thousands of present and future bondholders who were not such when the acts occurred and who acquired, or who hereafter acquire, such bonds which are still traded in by purchase.

note for the amount of such liability into the trust fund (R. 971). The resort to such a case, which wholly begs the question by presupposing a derivative suit for restoration lies contrary to New York law, shows the utter weakness of the ruling of the Court. As HUGHES, Ch. J., said in *Santa Cruz Co.* v. *Labor Board,* 303 U. S. 453, at page 467:

> "* * * what is reasonably clear in a particular application is not to be overborne by the simple and familiar dialectic of suggesting doubtful and extreme cases."

The error of the Circuit Court of Appeals in sustaining the injunction is best illustrated by the decisions upon which it relied.

Steelman v. *All Continent Co.,* 301 U. S. 278 (R. 985) involved the power of the bankruptcy court to enjoin the prosecution of a suit in another federal court directly affecting the debtor's property. Fox had been adjudicated a bankrupt in the district court in New Jersey and an order made for the examination of All Continent Corporation. As a result of this examination All Continent, which was a family corporation created by the bankrupt and to which he had transferred a substantial part of his assets, being all its capital, was ordered to deliver its books and papers to the trustee in bankruptcy. The stock of All Continent stood in the name of the bankrupt who had absolute control and there was evidence of transfers of property on the eve of bankruptcy.

At this point All Continent began a suit in the district court in Pennsylvania against a firm of stock brokers, a corporation called Capital Company and the trustee in bankruptcy to remove an alleged cloud on the title to stock held by the brokers in its name.

Capital Company had obtained a judgment against Fox in New York prior to the adjudication in bankruptcy and had served a third party subpoena in supplementary proceedings on the brokers to establish Fox's interest in the stock which they held in the name of All Continent.

Mr. Justice CARDOZO said at the beginning of his opinion:

> 'The question is one as to the power of a court of bankruptcy, in the situation developed in the record, to enjoin the prosecution of a suit in another federal court upon the ground that the suit, if pressed to a decree may thwart an inquiry into frauds charged against the bankrupt, or make relief against them difficult.' (p. 279).

Later the opinion continued:

> 'All Continent Corporation, if there is truth in the charges made by the trustee, is a party to a conspiracy to cover up the bankrupt's assets and keep them from his creditors. In that view of the facts, the suit in Pennsylvania will be a step in fulfilling the conspiracy, and may even crown it with success. The inquiry into the fraud, an inquiry going forward in orderly fashion under the supervision of the court of bankruptcy, will be transferred to another jurisdiction, with the supposed fraudulent grantee *as dominus litis.*' (p. 285).

It will be seen from the opinion (pp. 285, 286) that the Court placed great emphasis upon embarrassment in the orderly administration of the bankrupt's estate or even failure through successful fraud to determine his assets caused by the suit in Pennsylvania at the inception of the proceedings. The gist of the decision is found in these words:

> 'For reasons already indicated there was probable cause for the belief that the suit in Pennsylvania would be a step in the execution of a fraudulent conspiracy, impeding and perhaps frustrating the administration of the assets. There was probable cause for the belief that only through a suit upon the lines of the one in the New Jersey Chancery could the danger of obstruction be averted and the estate be kept intact until the entry of a decree adjudging the guilt or innocence of the putative conspirators. Whether they are innocent or guilty is a question not before us now. The data for the formation of any opinion on the sub-

> ject have not yet been supplied. At present our inquiry halts with the discovery of probable cause for preserving the estate from dismemberment or waste through a precipitate decision. If such cause has been made out, we think the court of bankruptcy has been armed with abundant power to preserve the *status quo* until there can be an adequate trial with all the necessary parties and a judgment on the merits.' (p. 288).

Finally it was said:

> 'Jurisdiction to administer the estate draws to itself, when once it has attached, an incidental or ancillary jurisdiction to give protection to the estate against waste or disintegration while frauds upon its integrity are in process of discovery.' (p. 289).

The decision in this case is far wide of the question now here.

Alexander v. *Hillman,* 296 U. S. 222, cited by the Court after its statement (R. 943),

> "The exercise of the Court's power to compel such an old trustee to restore trust assets, lost by its negligent conduct, concerns the res itself and is, therefore quasi in rem."

not only does not support its erroneous assertion but *contra* is authority for petitioner's claim. There the suit was by a receiver of a corporation against fiduciaries who were its officers and directors, *for dereliction in fraudulently misappropriating assets of the corporation and who still withheld the same.* This was a plain case of a suit in *rem* for the declaration of a constructive trust of such misappropriated property in the hands of the wrongdoers and directing restoration thereof to the receiver, and comes within the authorities cited on page 26 hereof.

Mandeville v. *Canterbury,* 63 S. Ct. 472, is authority in petitioner's favor. There this Court reversed an order of the Circuit Court of Appeals, Seventh Circuit, restraining

defendants from prosecuting an action in the state court which, like petitioner's suit here, was *in personam.*

Princess Lida v. *Thompson,* 305 U. S. 456 (R. 969), deals with rights under Pennsylvania law and is not apposite for various other reasons.

In the *Princess Lida* case, the accounting proceeding was by trustees of an *inter vivos* continuing trust, the proceeding and estate were by statute subject to the exclusive jurisdiction of the state court and the estate was to be continued by the trustees for further administration in accordance with the terms of the trust and the decree of the court. There the state court had jurisdiction over all of the interested parties and since the rights of all of them under state law could be adjudicated by that court in that proceeding, it was improper for two of the parties to that proceeding to seek relief in the federal court. In our case the trust terminated pursuant to the plan of reorganization; the former trustee is no longer acting as such and prior to its accounting turned over all of the pledged property it held. In our case former bondholders who sold their bonds prior to the date of the approval of the debtor's reorganization petition were neither parties to the reorganization nor to the accounting proceeding in the federal court which never obtained any jurisdiction over them. In the Pennsylvania case only the same parties were affected by both proceedings. In our case such former bondholders are not creditors of the debtor or beneficiaries of any trust being accounted for. Our case is not one where a creditor of the debtor who was a bondholder at the time of the reorganization and over whom the bankruptcy court had jurisdiction and who was a party to the accounting proceeding, seeks relief against the accounting trustee in another court.

The possibility that a decision in the state court will conflict with the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby*, affords no basis for upholding the injunction.

The Circuit Court of Appeals rendered its decision in *Manufacturers Trust* v. *Kelby* on February 3, 1942. On March 9, 1942, the Supreme Court of the State of New York, Special Term, New York County, rendered its decision in *Emmerich* v. *Central Hanover Bank & Trust Co.*, 34 N. Y. S. (2d) 166 (not otherwise reported). It was there held upon motion to dismiss the complaint that a bondholder cannot recover for breaches of trust against an indenture trustee, which consisted, as the breaches here, of unauthorized releases or surrenders of mortgaged property to the debtor-mortgagor, which were committed prior to his acquisition of bonds, in the absence of an assignment to him of the causes of action by the person who owned the bonds at the time of such breaches.

The order dismissing the complaint was unanimously affirmed by the Appellate Division, First Department, without opinion, on October 10, 1942, in 265 App. Div. 808 (Mem.).

Examination of appellant's brief at the Appellate Division shows that its counsel not only directed the attention of the court to the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby* as stating the law of New York but that it was the only case upon which he relied.[7]

It is difficult to conceive how the decision in *Manufacturers Trust Company* v. *Kelby* could have been more dis-

---

[7] Counsel stated in his brief:

> 'The question now presented is whether the holder of a bond has any standing to complain of a surrender of part of the trust res wrongfully made before he became a bondholder. It is submitted that none of the cases cited by the defendant in the brief it submitted, below, and none of the cases cited by the learned Special Term passes on this point. The only reported case which can be found directly in point is *Manu-*

tinctly presented to the state court. Leave to appeal to the Court of Appeals was recently granted by that court.

Here is an authoritative decision of a state intermediate appellate court of the precise question presented in *Manufacturers Trust Company* case rendered after the decision of the Circuit Court of Appeals in that case. The Circuit Court of Appeals under the decisions of this court should have overruled its decision in *Manufacturers Trust Company* v. *Kelby* instead of affirming it, as it did in *In re Prospect Avenue Holding Corp.*, 105 F. 2d 960, and reversed the injunction order.

> *Vandenbark* v. *Owens-Illinois Co.*, 311 U. S. 538; *Chase Corp.* v. *Vogel*, 312 U. S. 666.

It is significant that no claim has been made by the Circuit Court of Appeals that if the state court should adjudicate that when a former bondholder of the debtor sold his bond his cause of action against the trustee passed with it that such adjudication would be an interference with the jurisdiction of the federal court. The Court's claim of interference is not because of a continuance of the state court action or *any* adjudication that might be made by it but because of a probable adjudication in line with the decision in the *Emmerich* case and contrary to its decision in *Manufacturers Trust Company* v. *Kelby*, as reiterated in its decision here. It is true that an adjudication by the state court that petitioner has a cause of action would be a declaration of state law which the federal court would be constrained to follow, as this Court has repeatedly

---

facturers Trust Co. v. *Kelby, et al.* 125 Fed. 2d, 650, certiorari denied by U. S. Supreme Court [No. 1196, October Term, 1941, (decided, 1942) not yet officially reported]. In view of the fact that that case discussed the line of citations of authority urged by defendant, below, and also specifically differentiated the cases cited by the learned Special Term in its opinion, we are content to rest upon the applicable portion of the opinion of the Circuit Court of Appeals (quoted, post) as our brief upon this subject.' (p. 16, App. Brief).

ordained. Since this is a matter of constitutional limitation of powers of federal courts it is not interference but proper constraint.

If the state court follows the decision in the *Emmerich* case, which the Circuit Court of Appeals made no attempt to distinguish, petitioner will not thereby become a creditor of the debtor or acquire any right against any *res* even if such were to be deemed in possession and control of the bankruptcy court. The result of such a determination will be merely to define, as in an action for a declaratory judgment which is not one *in rem*, the parties who may sue Manhattan Company for such acts, to wit, the bondholders who were such when the unauthorized acts occurred, some of whom still are bondholders and some of whom no longer are, and to award to petitioner whatever damage it is entitled to from Manhattan Company.

II

The decision of the Circuit Court of Appeals is in conflict with its own prior decisions in the following cases: *In re Commonwealth Bond Corporation*, 77 F. 2d 308; *In re Adolph Goebel*, 80 F. 2d 849; *In re Prudence-Bonds Corporation*, 79 F. 2d 212.

In these cases the Court correctly held that when the state court suit does not touch the debtor's property and is not moved by one of its creditors, the suitor should not be impeded—that under Section 2(15) of the Bankruptcy Act the power granted to issue such injunctions as may be necessary for the enforcement of the provisions of the Act is limited to cases in which the property of the bankrupt is directly affected; that this limitation is also applicable to proceedings under Section 77B. Petitioner is not a creditor of the debtor and its suit does not affect any property of the debtor. *Vide* also *Bryant* v. *Atlantic Coast Line R. Co.*, 92 F. 2d 569; *In re Ambassador Hotel Corp.*, 124 F. 2d 435.

III

The process pursuant to which the proceeding was instituted against petitioner is insufficient.

Whether the bankruptcy court acquired jurisdiction over petitioner who, like former bondholders similarly situated, was not a party to the reorganization or accounting proceeding, by service of an order to show cause in a summary proceeding, depends upon whether petitioner is asserting any claim in the state action to property in the hands of Manhattan Company which belongs to the debtor. The complaint in the state action (R. 241, *et seq.*) determines that question. The Manhattan Company has delivered all the collateral held by it to the new trustee (R. 258); consequently, no turn-over order can lie against it.

> *In re Prospect Avenue Holding Corp.*, 2 Cir., 118 F. 2d 453; *Oriel* v. *Russell*, 278 U. S. 358; *Sheehan* v. *Hunter*, 8 Cir., 133 F. 2d 303.

In the absence of possession by Manhattan Company of any of the collateral and since petitioner does not seek to recover any part of such collateral, or any possession or control thereof, it is not an adverse claimant. Had petitioner been allowed to prosecute its action to execution, the bankruptcy court could not compel it by summary proceedings to pay over the sum recovered from Manhattan Company to the debtor's estate under any of the authorities. It is equally plain it had no power to restrain the prosecution of the action by summary process. The fact that Brooklyn Trust Company, the former trustee of the debtor's eighth series bonds, may conceivably not be in a position to object to the jurisdiction of the federal court over its accounting proceeding because it did not contest the order of the District Court directing it to account as trustee of such series, is no more justification for restraining the Coffin Estate, of which it is trustee, than it would be for restrain-

ing any one of the numerous former bondholders similarly situated from bringing a similar suit in the state court.

In re Prospect Avenue Holding Corp., supra, the Circuit Court of Appeals refused a turn-over order because the petitioner did not seek the possession of specific property or even the proceeds derived from the sale thereof but damages for its unlawful conversion and held that summary proceedings are inappropriate for suits not relating to recapture or preservation of the bankrupt's estate. The language in the opinion of SWAN, Circuit Judge, at page 455, is particularly applicable here. Here, as there, the debtor's trustees and other parties in the Manhattan Company accounting proceeding are not seeking to collect and bring into court some part of the bankrupt's estate *but are seeking to recover damages for wrongful acts which prevented the debtor's trustees from bringing into the estate property disposed of.*

Moreover, while the action in the state court is not a representative suit in a technical sense, the ultimate decision in it will govern the rights of all former bondholders against the various corporate trustees of the debtor's eighteen bond issues. Such former bondholders are a substantial class of absent parties to the accounting proceedings and over whom the federal court has no jurisdiction. (Cf. *Hansberry* v. *Lee,* 311 U. S. 32.) This question should not be determined upon an order to show cause served upon the testamentary trustee of one of thousands of former bondholders on a motion for injunction. Due regard for the protection of these former bondholders' rights, which due process exacts, requires that they have their rights against the former trustees defined in the state court.

IV

The construction placed by the Circuit Court of Appeals on Section 262 of the Judicial Code and Section 265 limiting it and the sections of the Bankruptcy Act upon which such jurisdiction must be based, violates the "due process" provision of Article V of the Articles in addition to, and amendment of, the Constitution of the United States of America.

While the injunction against petitioner is not perpetual it is far from temporary. It will not end when the accounting suit of Manhattan Company has been finally concluded although the rights of all who are parties to such suit will then have been resolved and terminated and although petitioner's suit is against Manhattan Company alone and not against any of the other accounting trustees, but will continue thereafter until the accountings of *all* of the other trustees have been finally concluded (R. 32). That an injunction against a suit need not be permanent to deprive a suitor of its property without due process is obvious. Moreover, since the state court suit is pending only as to the defendants Manhattan Company and Prudence-Bonds Corporation, the successor to the debtor which withdrew the collateral, and is not pending as to the bondholders Eddy and Reese, the effect of the injunction restraining the suit in so far as said Eddy and Reese are concerned is the same as an injunction which restrains the bringing of a future action against certain parties. Having no jurisdiction to grant a permanent injunction, the Court "in view of the decisions" had no power to restrain at all. It had no power to grant an injunction the effect of which was to oust the state court[8] even temporarily of a power found to reside in it alone by this court.

In *Chicago* v. *Fieldcrest Dairies, supra,* this Court said:

> 'The delicacy of that issue and an appropriate regard "for the rightful independence of state gov-

[8] *Hill* v. *Martin,* 296 U. S. p. 403.

> ernments'' (*Beal* v. *Missouri Pacific R. Co.*, 312 U. S. 45, 50) reëmphasize that it is a wise and permissible policy for the federal chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals'. (p. 172).

Petitioner is entitled under the decisions cited to establish the law of New York in the place where this Court has definitely held the Fifth Amendment requires it to be established. Either it has a cause of action against Manhattan Company or it has not. It has a right under the Federal Constitution to have the issue determined in the state court. The vindication of that right, so guaranteed, cannot be impeded upon any reasoning of the Circuit Court of Appeals.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated, Brooklyn, N. Y.,
May 6, 1943.

JACKSON A. DYKMAN,
RALPH W. CROLLY,
Counsel for Petitioner.